

#### NEW SECTION

**WAC 208-512-400 Purpose of these rules.** These rules are designed to help Washington state-chartered banks (Title 30 RCW), savings banks (Title 32 RCW) and savings associations (Title 33 RCW) establish, reiterate, integrate and maintain their own policies and procedures regarding subprime and nontraditional mortgage lending guidance. These policies and procedures are required by a new state law, chapter 108, Laws of 2008 (chapter 19.144 RCW).

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**WAC 208-512-410 What is the "guidance"?** Because of concerns about problems with subprime mortgage lending, the federal government issued the *Interagency Guidance on Nontraditional Mortgage Product Risks* and a *Statement on Subprime Mortgage Lending* (collectively, "the guidance"). In 2007, the governor convened the Washington state task force for homeowner security. The task force recommended including the federal guidance in state legislation. The 2008 Washington state legislature enacted SHB 2770, requiring the department of financial institutions to apply the two guidance documents to financial institutions in Washington. Starting in 2008, credit unions, banks, savings banks, savings associations, mortgage brokers and other Washington state consumer loan companies (collectively, "financial institutions") must have policies and procedures that use the guidance.

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**WAC 208-512-420 What does the guidance require of banks, savings banks and savings associations?** The stated intent of the guidance is to help borrowers to better understand adjustable rate mortgage (ARM) risks. The guidance requires financial institutions to have policies and procedures that focus on the various risks of subprime/nontraditional mortgage lending. The guidance requires financial institutions to be aware of portfolio and risk management practices, to use appropriate underwriting standards and to abide by consumer protection principles. Financial institutions also

need to maintain strong internal control systems. Many of the recommendations in the guidance are good business practices and may already be followed by financial institutions.

Not all of the elements of the guidance may be applicable to all banks, savings banks and savings associations, or to all other financial institutions. Banks, savings banks and savings associations must determine which elements are relevant to their operations, and incorporate only those subjects into their policies and procedures.

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**WAC 208-512-430 Is there a list of subjects that banks, savings banks and savings associations must include in their policies and procedures?** Yes, the guidance requires all financial institutions, including banks, savings banks and savings associations, to focus on the following subjects and apply the relevant ones to their existing policies and procedures:

- Help borrowers understand ARM risks, including:
  - Low initial payment;
  - High or unlimited reset rate caps;
  - Low or no documentation loans;
  - Problems of frequent refinancing;
  - Risk layering;
  - Simultaneous second lien loans;
  - Prepayment penalties;
  - FDIC prohibited practices (banks, savings banks and savings associations);
  - OTS prohibited practices (savings associations).
- Understand portfolio and risk management practices, including:
  - Relationship between subprime lending and predatory lending;
  - Risks of loans based on foreclosed or liquidation value;
  - Problem of loan "flipping";
  - Fraud detection;
  - Use of qualifying standards;
  - Maintenance of appropriate capital levels;
  - Use of appropriate allowance for loan and lease loss levels;
  - Risks of stated income loans;
- Underwriting standards.
- Workout arrangements.
- Consumer protection principles, including:
  - Use of a summary disclosure form;
  - Avoidance of steering borrowers to inappropriate products;
  - Explanation of payment shock risk;
  - Explanation of prepayment penalty;
  - Explanation of balloon payment;
  - Explanation of costs of low documentation or stated income

loans;

- Compliance with the Truth in Lending Act and other federal requirements;

- Importance of good consumer communications in promotional materials and product descriptions;

- Explanation of borrower responsibility for taxes and insurance.

- Development and maintenance of strong internal controls, including:

- Management of deals with third-party originators;

- Management of secondary market risk;

- Effective management information and reporting;

- Use of stress testing and performance measures;

- Actual practices consistent with policies.

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**WAC 208-512-440 Where can I read the guidance documents?** You can find the two federal guidance documents on the internet: <http://www.fdic.gov/news/news/press/2006/pr06086b.pdf>; and <http://www.fdic.gov/news/news/press/2007/pr07055a.html>.

You can also click on the links on the DFI web site at [www.dfi.wa.gov](http://www.dfi.wa.gov).

If you do not have internet access, you may contact the department of financial institutions, division of banks (division of banks) for a copy of the documents.

Read these documents to ensure proper application of the law to your institution and to comply with the required integration of the guidance into your policies and procedures. If your institution needs help incorporating the guidance or reconciling it to your policies and procedures, contact your legal counsel.

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**WAC 208-512-450 Why do I need to read the federal guidance documents?** The federal guidance consists of two lengthy documents that are very detailed. Because they are required by state statutory law, they apply in their entirety. Division of banks cannot merely summarize them or give you a checklist. You must read the documents in order to apply them to your particular institution by means of integrating the guidance into your own policies and procedures.

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**WAC 208-512-460 What will the division of banks do about compliance with guidance policies and procedures?** Every state-chartered bank, savings banks and savings association is different. There is no "one-size-fits-all" guidance available. Division of banks will not issue model guidance, because the process of self-analysis that your institution needs to do, in order to develop its own guidance policies and procedures, is beneficial. The division of banks does not provide technical legal advice. Also, the guidance is complex and will result in variations in wording or applicability of guidance policies and procedures among institutions, depending upon the size and complexity of a particular institution, the overall characteristics of its mortgage lending market base, and the specific types of mortgage lending it does, if any.

For supervision purposes, the division of banks will:

(1) Verify that an institution has integrated the guidance into its policies and procedures, as part of its risk-focused examination. Division of banks will not mandate the length or exact wording used in the guidance policies and procedures.

(2) Review the guidance policies and procedures with the institution, if a consumer complaint indicates a problem or issue regarding subprime and nontraditional mortgage lending practices.

(3) Verify that an institution is following its policies and procedures.

The division of banks expects prompt compliance by banks, savings banks and savings associations with the requirements of this rule.

The law provides the division of banks with examination, enforcement and investigation authority to take appropriate action against banks, savings banks and savings associations that are in noncompliance with the guidance policies and procedures requirement.